EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				
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8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/EEO				
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15	D/OLL				
16	C/PAO				
17	SA/IA				
18	AO/DCI				
19	C/IPD/OIS				
20	NIO/ECON ✓		✓		
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SUSPENSE ____________ Date

Remarks

STAT

Executive Secretary

2/28/84

Date

3637 (10-81)

WASHINGTON

Executive Registry
84 - 1067

CABINET AFFAIRS STAFFING MEMORANDUM

84 FEB 28 A10 : 21

Date: 2/27/84 Number: 168923CA Due By: ____________

Subject: Minutes of the Cabinet Council on Economic Affairs - January 26, February 10, 14, & 16, 1984

	Action	FYI
ALL CABINET MEMBERS	☐	☑
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Attorney General	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
GSA	☐	☐
EPA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
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Baker	☐	☑
Deaver	☐	☐
Darman *(For WH Staffing)*	☑	☐
Jenkins	☐	☑
McFarlane	☐	☑
Svahn	☑	☐
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CCCT/Gunn	☐	☑
CCEA/Porter	☐	☑
CCFA/ •	☐	☑
CCHR/Simmons	☐	☑
CCLP/Uhlmann	☐	☑
CCMA/Bledsoe	☐	☑
CCNRE/	☐	☑

REMARKS: Attached for your information are the minutes from the following Cabinet Council on Economic Affairs' meetings:

January 26
February 10, 14, & 16

DCI EXEC REG

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2323

☐ Katherine Anderson
☑ Tom Gibson
☐ Don Clarey
☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800

L-300B

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 26, 1984
2:00 p.m.
Roosevelt Room

Attendees: The Vice President, Messrs. Regan, Baldrige, Brock, Feldstein, Svahn, Porter, Abrams, Ballentine, Ford, Jones, Lyng, Simmons, Wallis, Wright, Cicconi, Coy, Gibson, McAllister, Neal, Rhodes, Robinson, and Li, Ms. Dole and Ms. Risque.

1. Report of the Working Group on the Economic Impact of International Trade

Sidney Jones, Under Secretary of Commerce for Economic Affairs, presented the report of the Working Group on the Economic Impact of International Trade regarding possible macroeconomic policy actions to reduce the U.S. merchandise trade and current account deficits. At its October 4 meeting, the Council asked the Working Group to consider specific recommendations to improve the U.S. trade deficit. A report on microeconomic policy options will be presented in a subsequent meeting.

Mr. Jones presented projections of the U.S. merchandise trade and current account deficits. The Department of Commerce's Bureau of Economic Analysis (BEA) projects that the U.S. merchandise trade deficit will be about $70 billion in 1983, $110 billion in 1984, and $125 billion in 1985. BEA also projects that the U.S. current account deficit will be about $40 billion in 1983, $85 billion in 1984, and $95 billion in 1985. The Organization for Economic Cooperation and Development (OECD) projects that the U.S. current account deficit will be approximately $40 billion in 1983, $82 billion in 1984, and $95 billion in 1985.

Mr. Jones observed that the U.S. experienced merchandise trade deficits in 1983 with both developed and developing countries. While the trade deficit with Japan has remained stable at about $18 billion over the last two years, the trade deficit with Canada increased from $2 billion to $14 billion, a swing of $12 billion over two years, and the trade balance with Latin American and Western Hemisphere countries changed from a $4 billion surplus to a $17 billion deficit, a swing of $21 billion over two years.

Mr. Jones stated that the shift in the U.S. current account balance can be attributed in large part to a decline in the income from U.S. direct and portfolio investment abroad, which in turn resulted from both a decline in net investment and lower income from those investments. The surplus of U.S. net investment is only $130 billion. If the U.S. continues to experience current account deficits of the magnitude projected, the U.S. could become a debtor nation.

Mr. Jones pointed out that there is a close negative correlation between movements in the value of the U.S. dollar and changes in U.S. net exports. A rising value of the dollar results in a reduction in net exports. The current lag of 4-5 months between changes in the value of the dollar and its effect on U.S. net exports is much shorter than the traditional lag of 15-18 months. He noted that from July 22, 1980 to January 3, 1984, the trade-weighted value of the U.S. dollar appreciated vis-a-vis the French franc by 111 percent, the German mark by 62 percent, the Japanese yen by 6 percent, and the Italian lira by 106 percent.

The Working Group attributes the high value of the U.S. dollar primarily to high U.S. real interest rates. While both short- and long-term interest rates are much lower now than they were in 1980, the bulk of the decline occurred before 1983. Real interest rates are higher in the U.S. than elsewhere and appear to be on an upward trend.

Mr. Jones explained that the large trade deficits posed several problems for the U.S. Economic production has been adversely affected by the slowdown in U.S. exports. The erosion of exports and increase in imports have increased protectionist pressures to restrict imports. The historical U.S. net investment position in the international economy is eroding. U.S. foreign investments totaled $834 billion and foreign claims against the U.S. totaled $666 billion in 1982, leaving a positive balance of $168 billion. That surplus is expected to decline by about $40 billion in 1983.

He stated that the Working Group had reviewed five macro economic policy options:

(1) Continuing existing policies while waiting for anticipated cyclical adjustments to reverse the recent rapid increases in the merchandise trade and current account deficits;

(2) Erecting trade barriers such as quotas, tariffs, and other measures to improve the U.S. trade position;

(3) Restraining Federal budget outlays to reduce prospective budget deficits;

(4) Increasing prospective Federal revenues; and/or

(5) Pursuing a monetary policy aimed at encouraging exports and discouraging imports by reducing the value of the dollar.

Mr. Jones stated that the Working Group recommends the Administration continue the current macroeconomic policies. He noted that there are several factors suggesting that this is the most appropriate course, including: the expected decline in the value of the dollar in 1984; the moderation of the U.S. recovery; the anticipated revival of economic growth among our trading partners; and the possibility of lower U.S. interest rates.

The Council's discussion focused on several issues including the causes of the high value of the U.S. dollar; the possible adverse effects of a decline in the value of the dollar, such as increased inflation; and foreign capital inflows into the U.S.

The Cabinet Council asked the Working Group to analyze the implications of a slow or rapid decline of the value of the U.S. dollar on the merchandise trade account, inflation, interest rates, and other key variables. In addition, the Working Group will consider what policy actions the Administration should consider for 1985 and beyond to address the prospective trade imbalances.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

February 10, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs: Regan, Pierce, Hodel, Feldstein, Porter, Wright, Brown, Burnley, DeMuth, Ford, Horowitz, Lyng, Naylor, Wallis, Alm, Cicconi, Gibson, Gray, Leonard, McMinn, Neal, and McAllister.

1. Proposed Rural Electrification Administration (REA) Legislation

Under Secretary Naylor presented the Cabinet Council with an update on the legislative status of the Rural Electrification Revolving Fund Self Sufficiency Act (S. 1300, H.R. 3050), which has a total cost of $20.7 billion, including foregiveness of $7.9 billion in long term debt owed the Department of the Treasury. The House Agriculture Committee has approved the bill but deleted the provision permitting the refinancing of certificates of beneficial ownership (CBO's), which would cost $8 billion. There is considerable pressure for action in the Senate.

Mr. Naylor pointed out the the Administration has drafted alternative legislation that would place the REA on budget; raise the lending rate to the cost of Treasury borrowing; and require user fees to cover expenses. There are currently no sponsors of Administration legislation, reflecting the slight prospects for the Administrations proposal, and the strong support for the Rural Electrification Revolving Fund Self Sufficiency Act. He stated that Secretary Block has written to House Agriculture Committee Chairman De La Garza expressing his strong opposition to H.R. 3050 and stating that he would suggest the President veto the bill. Mr. Naylor asked for additional support from the White House and the Treasury in opposing the bill.

The Cabinet Council unanimously agreed to oppose the bill, reasoning that even if we were able to negotiate successfully a less expensive bill, it would still be unacceptable. Secretary Regan asked that Mr. Porter convey the Council's recommendation to the appropriate persons in the White House.

2. Report of the Working Group on Regulation and Market Intervention

Christopher DeMuth presented a proposal for a regulatory policy planning process, as requested by the Cabinet Council at its December 10 meeting. He explained that an enhanced regulatory policy process could prove a major improvement over the current decentralized and incremental regulatory process.

Mr. DeMuth stated that in his view the Administration has had excellent success in discipling the regulatory process; good success in revising inherited rules; and fair success in challenging and changing the underlying philosophies regarding health, safety and environment regulation. The Administration currently is seeking a number of statutory changes in economic regulation, such as natural gas and financial services.

Mr. DeMuth explained that the proposed regulatory planning process would be based on the Administration's experience with Executive Order 12291, the Task Force on Regulatory Relief, the paperwork budget and the regulatory agenda, which is published twice each year. The process would begin in the January-March period and would consist of four steps:

1. Each major regulatory agency would prepare a policy document setting forth general policy goals and priorities for the coming year; the most significant reviews of existing rules to be undertaken during the year; and the most significant new rules to be considered during the year.

2. These policy documents would be reviewed by OMB, which might suggest different or additional reforms, identify interagency conflicts, or raise broader economic issues.

3. Each agency's plan would be presented to a senior Administration policy group (such as the CCEA) and to the President.

4. Final agency plans would be compiled and published as a single Administration policy document.

Mr. DeMuth stated that such a process would permit an overview of policies underway and preview issues likely to require high level attention. Some examples of issues likely to be considered in such a process include automobile fuel economy standards, Food and Drug Administration regulations, and cross cutting interagency issues, such as the confidentiality of business information. He suggested instituting the process this year as a pilot to assure a smooth functioning process in 1985.

Many of the Council members expressed support for the thrust of the proposal and recognized the need for regulatory policy oversight by senior level Administration officials. However, several members expressed concern regarding the degree of detail in the oversight; the possibility of imposing another layer of paperwork; and the chance that the courts might interpret the proposed process as a violation of ex parte prohibitions.

Secretary Regan asked Messrs. DeMuth and Porter to more sharply define the proposed process, reflecting the concerns raised, for further Cabinet Council consideration.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

February 14, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Darman, Porter, Wright, Ballentine, Burnley, Chapoton, Egger, Ford, Simmons, Baroody, Gibson, McAllister, Neal, Platt, Li, and Ms. Risque.

1. <u>Report of the Working Group on Unemployment and Unemployment Compensation</u>

Mr. Porter reviewed the Cabinet Council's previous consideration of a proposed National School-to-Work Transition Program modeled after Delaware Governor du Pont's Jobs for Americas' Graduates (JAG) program. At its December 20 meeting, the Cabinet Council decided to recommend that the Administration encourage States and localities to use existing authority to establish school-to-work transition programs and asked the Office of Policy Development, the Office of Management and Budget, and the Department of Labor to work with representatives of the JAG program to develop the most appropriate ways for the Administration to encourage such programs. Subsequently, representatives of the JAG program proposed a $25 million to $50 million demonstration school-to-work transition program with funds reprogrammed from the Summer Youth Employment Program.

Secretary Donovan reviewed the elements of the JAG program and the reprogramming proposal. While the JAG program has demonstrated some short-term value, its long-term success has yet to be demonstrated. The major problem with reprogramming funds from the Summer Youth Employment Program to finance a school-to-work transition program is that it would be perceived as taking money from low-income youth to help middle-income youth. The Secretary stressed the importance of not opening up JTPA.

The Council discussion emphasized the importance of maintaining the block grant approach in the Job Training Partnership Act (JTPA). Council members pointed out that the States could use funds for school-to-work transition programs from the block grants in JTPA, the Wagner-Peyser Act, as amended, and Title II of the Elementary and Secondary Education Act. Seeking a set aside in JTPA would run the risk of substantially increasing Federal spending since the temptation for expanding funding in an election year will be powerful.

The Council observed that reauthorization of the Vocational Education Act would provide another opportunity for States to finance school-to-work transition programs. Vocational education is designed for the youth who would be targeted by a school-to-work transition program. Moreover, including a program providing job search assistance in vocational education would complement the job training activities in the program. Council members strongly supported encouraging States to adopt a school-to-work transition program in vocational education, rather than creating a set aside in the Act.

The Council unanimously agreed to recommend: (1) encouraging States and localities to use existing authority and flexibility to establish school-to-work transition programs modeled after JAG; (2) expanding eligibility under the Vocational Education Act to include school-to-work transition programs; and (3) not proposing a set-aside for school-to-work transition programs in the Vocational Education Act reauthorization.

2. OECD Conference on Employment Growth

Mr. Porter briefly summarized the recent Organization for Economic Cooperation and Development (OECD) Conference on Employment Growth in the Context of Structural Change. He noted that:

(1) Europeans are very pessimistic about their prospects for economic growth and job creation;

(2) Despite this pessimism, no one at the Conference was prepared explicitly to advocate protectionist measures. Conference participants recognized that protectionism rarely produces job savings; and

(3) Virtually all the participants agreed on the need to achieve more flexible labor markets.

Council members discussed the shift in orientation of the U.S. toward Asia because of the growth in Asian markets, which results in part from the greater flexibility in their economies.

Secretary Regan requested that a working group be established to develop ways of emphasizing the importance of promoting flexibility in economies at the OECD Ministerial meeting in May.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

February 16, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Feldstein, Darman, Porter, Wright, Ballentine, Burnley, Chapoton, Egger, Ford, Simmons, Baroody, Gibson, McAllister, Neal, Platt, Wade, Li, and Ms. Risque.

1. Report of the Working Group on the Underground Economy

Commissioner Egger presented the report of the Working Group on the Underground Economy, one of the thirteen economic policy studies commissioned by the Cabinet Council on June 30, 1983. The Working Group defined the underground economy as "economic activity which is not properly reported to the government and which is either itself illegal or is conducted informally to minimize the chances of detection by government authorities."

Mr. Egger identified several problems with the underground economy:

1. Lost Federal revenue. While the income tax gap of $91 billion in 1981 is large, the proportion attributable to the underground economy is relatively small, about $14 billion or 15 percent.

2. Excessive entitlements. The effect of the underground economy on Federal budget outlays is difficult to judge because few agencies have systematically estimated the proportion of fraud in assistance programs due to participation in the underground economy.

3. Illegal economic activity. The annual tax revenue loss due to illegal activities (drugs, gambling, and prostitution) is an estimated $9 billion.

4. Economic statistics. A large and growing underground economy could bias economic measures, such as gross national product, inflation, and unemployment.

Mr. Egger presented several Working Group proposals for discussion:

- To identify those individuals performing a sufficiently high value of services without reporting that income, the Federal Government could require individuals to report payments where the amounts exceed some threshold value.

- Systems to measure fraud due to concealment of income could be established for all entitlement programs with significant potential for such fraud.

- To reduce the opportunities for income maintenance recipients to work in the underground economy, the Federal Government could require that able-bodied adult beneficiaries of various income maintenance programs to participate in community work experience programs.

2. The Income Tax Gap

Mr. Egger presented a paper on the income tax gap, which is defined as the difference between the correct tax liability for a year and the amount voluntarily paid for that year. The income tax gap has risen steadily from about $31 billion in 1973 to about $91 billion in 1981. In addition, the compliance rate has declined from 84 percent in 1973 to 81 percent in 1981.

The income tax gap of individual filers in 1981 was about $66 billion, which comprised $52 billion of unreported income, $7 billion of overstated personal deductions, $6 billion of overstated business expenses, and less than $1 billion of net math errors.

There are two key IRS programs directed at reducing taxpayer noncompliance:

A. Information returns program. By matching information documents (which report wages, interest, dividends, etc.) received from taxpayers against appropriate tax returns, the IRS can identify taxpayers with discrepancies. In about 50 percent of the cases with discrepancies, the taxpayer reported the figure elsewhere on the return. In the other 50 percent, the IRS had to contact the taxpayer. The information returns program has a yield/cost ratio of 10 or 11 to 1.

B. Examination program. Through selecting for audit the most productive returns, the IRS maximized the use of its resources. However, the proportion of tax returns filed that are audited by the IRS has declined to less than 1.4 percent in 1984.

Revenues collected from direct enforcement efforts have risen from $15.3 billion in FY 1980 to $33.8 billion in FY 1985 (1983 dollars), even though IRS resources increased from $2.8 billion to only $3.5 billion.

The Council discussed the need to focus on the income tax gap as a whole, rather than differentiating it into "underground" and normal economies. In addition, the Council discussed the importance of focusing on ways of addressing the fundamental cause of the problem: cheating, rather than simply trying to alleviate the problem by increasing collection efforts.

The Council requested that the Working Group further analyze the tax gap and how various tax simplification and reform proposals would likely affect it for consideration at a future meeting.